The most liberal commercial agency law of the Gulf…

By Jochen Hundt, LL.M.

Exporters acquainted with the legal situation of the Middle East know that whoever intends to operate actively in the markets of the oil-rich monarchies along the Gulf is often restricted or even prevented by law from distributing his products himself. Indeed, the GCC countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) have enacted legislation which forces foreign producers to appoint a local agent or distributor who takes in hand the marketing, distribution and after-sales service for the imported line of products. In many cases the agent or distributor must either be a local individual or a trading company owned by locals, in most cases at 100%.

Commercial agencies are lucrative business and the legislation in place often aims at protecting the agent to a maximum extent. Agent-friendly statutes continue to be in force throughout the GCC, despite the accession of all GCC member countries to the WTO. The existence of such statutes was certainly justified in the 1960's, at a time when indigenous village traders had to face the economic might of the North American and European industries, but the situation today has changed to the point that the turnover of some GCC trading houses exceeds the turnover of their manufacturing partners abroad. Consequently, the agency legislations of the Gulf are often much criticized, especially by foreign exporters and their organizations.

In this context it is worth mentioning that the Kingdom of Saudi Arabia, by virtue of its Commercial Agencies Law of 1962 (Royal Decree no. 11 of 1382H) and the corresponding Executive Regulation, has put into force, and applies until today, the most liberal legislation within the GCC. This characteristic may be illustrated by the following examples:

Unregistered agreements are enforceable

As opposed to the situation in the rest of the GCC, Saudi courts consider and enforce agency and distributorship agreements that have not been registered with the authorities. In fact, even though Article 3 of the Saudi Commercial Agencies Regulation makes registration a duty upon the agent or distributor, not only are the relevant penalties never applied but also the Saudi judges do not make any distinction in applying agency agreements, whether registered or unregistered. Despite the letter of the law, it is in practice fully up to the contractual parties whether or not to register the contract.

Exclusivity not compulsory

The Saudi Commercial Agency Law does not require a commercial agent to enjoy exclusivity for the contractual territory and the agreed product line. Unlike the situation under UAE agency law a foreign producer has always been able to appoint two or more agents or distributors in Saudi Arabia, even for the same products and the same territory (region, city, etc.). In practice the parties to an agency or distributorship agreement sometimes decide to make the principal's right to appoint another agent subject to the agent fulfilling a number of contractual obligations, in particular the compliance with a minimum turnover scheme.

No minimum duration

Other than its Kuwaiti counterpart, the Saudi Agency Regulation does not require the parties to agree on a minimum contractual term. In the 1990s, a reform of the Saudi Agencies Law was under discussion, which included a minimum contractual term of 5 years in case the agent or distributor had to invest in warehouses, showrooms or workshops. However, these amendments have never been enacted by the Saudi government. The parties to an agency agreement are therefore free to convene on any duration. Allowed are even indefinite-term agreements, which can be cancelled at any time by simple notice, provided that the contract provides for an initial defined term (for example 1 year after which the agreement becomes indefinite).

No minimum compensation in case of termination

In the majority of the GCC countries, and especially in the United Arab Emirates, the rights of the agent or distributor are something tantamount to a title of ownership over the agency or distributorship. This means in practice that any principal who terminates or even refuses to renew an agency agreement for a reason other than a serious breach by the agent of the terms and conditions of the contract is considered by law to be guilty of an abuse of rights and is therefore liable to pay the agent compensation at several times the average yearly turnover. Even though in Saudi Arabia, too, it is not always easy to change one's agent or distributor the law does not restrict the contractual freedom of the parties with regard to the issue of compensation. Thus the courts are bound to enforce any clause restricting or even excluding compensation to be paid to the agent in case of termination. It is true that in case of an agency dispute, many judges tend to encourage the parties (and especially the foreign principal) to agree to an “amicable” settlement, which most of the time includes some compensation amount to be paid to the agent, and to delay the judgment. Nevertheless, at the bottom line, the Saudi judge has no other choice than to enforce a freely agreed exclusion or limitation clause. The best solution in practice, as per the mindset of the courts, is often a clause that makes compensation subject to the agent complying with a list of important contractual obligations, which have to be spelled out in detail.

Foreign Arbitration?

Saudi Arabia has been a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards since 1994. By virtue of the convention, arbitral awards rendered in any signatory country are legally enforceable in the Kingdom. Also the Model Agency Contract of the Saudi Ministry of Commerce provides that disputes may be referred to the courts or alternatively to “local or foreign” arbitration. In practice, however, there seems to be still no established track record of foreign arbitral awards that were actually enforced in Saudi Arabia. The situation is different with arbitral awards rendered in Arab and specifically GCC countries (such as by the DIAC) because the respective convention of the States of the Arab League and the respective GCC Protocol are better being implemented in the Kingdom. Nevertheless, to ensure swift enforcement the best forum selection in the interest of the foreign principal is usually ‘Saudi Commercial Courts’ in combination with ‘Saudi law’.

Foreign Investment

In April 2007, Saudi Arabia implemented a provision of the WTO accession treaty which allows foreign investors to hold up to 75% of the capital of distributor companies. However, a minimum capital investment of SAR 20 million is required from the side of the foreign investor alone, plus the respective amount by the local partner. The workforce of the company must be “saudiized” at 75%. Commercial agencies, to the contrary, are still part of the so-called ‘negative list’ i.e. foreign investment is not permitted in this sector.